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PACIFIC  **TELESIS**
Group-Washington

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March 3, 1997

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Federal Communications Commission
Office of Secretary

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, NW, Room 222
Washington, DC 20554

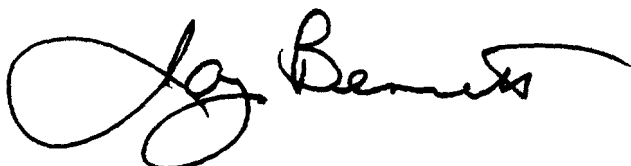
Dear Mr. Caton:

Re: *RM 9006, Petition for Rulemaking to Reclassify AT&T as Having Dominant Carrier Status*

On behalf of Pacific Telesis Group, please find enclosed an original and six copies of its "Reply" in the above proceeding.

Please stamp and return the provided copy to confirm your receipt. Please contact me should you have any questions or require additional information concerning this matter.

Sincerely,



Enclosures

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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MAR 3 1997

Federal Communications Commission
Office of Secretary

In the Matter of

Petition for Rulemaking to
Reclassify AT&T as Having
Dominant Carrier Status

RM 9006

REPLY OF PACIFIC TELESIS GROUP

In accordance with Section 1.405(b) of the Commission's rules,¹ Pacific Telesis Group ("we" or "Pacific") respectfully replies to the Opposition of AT&T to the above-captioned Petition of the United Homeowners Association and United Seniors Health Cooperative ("Petitioners").

We take no position at this time on whether AT&T should be reclassified as a dominant carrier. We would, however, like to reply to AT&T's Opposition with facts that it neglected to state, and suggest a solution to the problem that Petitioners accurately describe.

Long Distance Prices Continue to Increase. Though AT&T never mentions it, the Telecommunications Reform Act of 1996 (the "1996 Act") demonstrated by itself Congress's extreme concern about the domination of the interLATA market by the big three IXC's. Congress heard testimony of their lockstep price increases, always led by AT&T. It was spectacularly unswayed by

¹ "Any interested person may file a reply to statements in support of or in opposition to a petition for rule making prior to Commission action on the petition but not later than 15 days after the filing of such a statement." The Public Notice of the petition (DA 97-123, released Jan. 16, 1997) appears to have overlooked this rule, as it did not mention replies. But the public interest is always presumptively served by following the rule, and in the unlikely event the Commission decides that the rule should not be followed, we respectfully ask these Reply Comments be treated as an ex parte presentation.

the IXC's "astroturf roots" campaign of telegrams from customers who hadn't authorized them (or customers who were dead -- described by one legislator as "long distance at its best").² Despite the all-out opposition of the incumbents, Congress provided for interLATA entry by the RBOCs.³

AT&T claims that Petitioners' "unsupported claims" of "tacit collusion" among big IXC's "must fail. The long-distance industry is in fact one of the greatest success stories of both antitrust law and the Commission's policies.... there are hundreds of companies providing long distance service ... as of 1994 carriers other than AT&T, MCI and Sprint accounted for over 17% of the market and can exert substantial 'downward pressure on price.'" (AT&T, pp. 3-4.) It is therefore all the more strange that AT&T never controverts the Petitioners' presentation of *rising* prices. Even if as AT&T alleges the evidence of tacit collusion had been "conflicting and inconclusive" before AT&T's deregulation, it is not "inconclusive" anymore. The fact is that AT&T has continued to raise its prices even after the Commission declared that it was nondominant. As Petitioners point out (p. 3), these price increases affect all of the big IXC's customers except those on flat rate plans.

Although the big IXC's occasionally still allege that "prices" have declined, they never actually try to prove it. For example, in a recent (January 27, 1997) "White Paper" that MCI distributed to the media entitled "True Competition in the Long Distance Market," MCI documented reductions in "revenues per minute" adjusted for inflation. See also AT&T Opposition, p. 2, n.3. But "revenues per minute" aren't prices. Prices can be rising across the board even as "revenues per minute" fall. Consider a customer who switches from paying MTS prices to a volume discount plan with rates that are discounted 10% from MTS rates. Assume the consumer starts out paying for 100

² "Grass-Roots' Lobbying Reaches Under the Sod," The Wall Street Journal, Aug. 4, 1995; "Liberal Urging Has Given Way to Eerie Hush," The New York Times, Nov. 24, 1995.

³ See 47 U.S.C. Section 271.

minutes per month at \$.20 each; then shifts to a discount plan that costs her \$.18 per minute. Revenues per minute fall 10%, but MTS prices stay the same. In fact, AT&T could raise its MTS rates by any amount less than 10% (or whatever the percentage amount of the discount), and for that customer, its revenue per minute would still fall. Assume for example that a consumer starts out paying for 100 minutes per month at \$.20; then AT&T raises its undiscounted price to \$.21; then the consumer shifts to a 10% discount plan that costs her about \$.19 per minute. Revenues per minute fall about 5%, even though prices have risen about 5%.

As these examples show, changes in revenues per minute don't show that prices have decreased. They show that prices have been *restructured*. As Petitioners point out, "greater profit margins from basic rates [have been] used to offset the cost of offering incentives to attract high volume users" (Petition, p. 3), who have the option of building or leasing their own private networks. For the majority of consumers, who aren't on volume discount plans, prices have risen. Measuring "revenues per minute" instead of prices disguises both the overall increase in prices and the shifting of the price burden to the majority of consumers who don't get volume discounts. MTS prices have gone up about one-third since 1991. According to testimony in California, 55% of AT&T's customers are not on any calling plan, but pay MTS prices.

Recently, since even "revenues per minute" have begun to rise, the big IXCs have had to resort to another, more familiar, and in this case completely specious statistical trick, which is to adjust them for inflation. But there is no inflation in the IXCs' costs. Falling access charges, improved technology, and growing demand (which, because of the cost characteristics of fiber optic networks, the big IXCs can satisfy with hardly any incremental growth in costs) have been used to increase profit margins instead of reduce prices. In California, the big IXCs' marginal profits have risen to about

sixty-five cents of every dollar that consumers pay for MTS service, about two to three times as high as margins in competitive industries. AT&T's network costs are about one cent per minute. It pays another 2.7 cents in access charges for calls that begin and end within our area. Yet its average "revenues per minute" are nearly ten cents for calls in California and fourteen cents nationwide. In 1995, Pacific Bell reduced its California access charges in California by nearly 50%, reducing AT&T's access bill by \$303,000,000 a year. AT&T reduced its California prices by \$155,000,000 and kept the rest for its shareholders. MCI and Sprint followed suit. AT&T's marginal profit on each call within the state rose about 21% that year. The figures are all from AT&T's own testimony. AT&T reported net earnings in California of 79% for 1995.⁴

This doesn't sound to us like "one of the greatest success stories" of our times. In competitive markets firms compete for market share by reducing prices, even if that means reducing marginal profits. The long distance industry, by contrast, is remarkably concentrated (with an oligopoly of three firms owning 87 percent of the market), remarkably profitable, and remarkably stable, with little change in market share. In California MCI's market share hasn't changed at all since 1992. Sprint's market share in California has also remained statistically unchanged since 1992.

⁴ The IXC's like to use operating cash flow -- earnings before interest expense, taxes, depreciation, and amortization, or "EBIDTA" -- to compare themselves to the local exchange industry. EBITDA is one way that financial analysts compare the performance of firms in the same industry, or the performance of a single firm over time. But they don't use it to compare firms in different industries, because different industries have different cost characteristics. The local exchange business is one of the most capital-intensive there is. EBITDA treats the costs of telemarketing and celebrity advertising as a reduction in profits, but not the indebtedness a local exchange carrier incurs to install a switch.

Big IXC's also like to say that their heavy advertising is evidence of competition. But economists deduced a long time ago that the opposite is the case. The higher the profit margin on a product, the more incentive businesses have to advertise it. That's why advertisements for high-margin products -- from soft drinks to perfumes to sport-utility vehicles to long distance -- dominate the airwaves.

AT&T has lost a few points of share, but not to its fellow oligopolists -- only to niche players that, as rising prices prove, are unable to exert significant downward price pressure.

The long distance oligopoly continues to resist all reforms. Not only does it oppose the entrance of the RBOCs, but it has resisted the Commission's mandatory detariffing of the interstate long distance market. When the Commission agreed with the Supreme Court that tariffing may help facilitate tacit price-fixing and ordered mandatory detariffing, Sprint and MCI took it to court; MCI filed a motion for stay.

New Facilities-Based Entry is the Best Solution to Rising Prices. In the 1996 Act, Congress demonstrated its belief that an ounce of competition is worth a pound of regulation. It established a "pro-competitive, de-regulatory national policy framework"⁵ that outlawed all State and local prohibitions on the ability of any entity to provide interstate or intrastate telecommunications service,⁶ required the Commission to forbear from applying any regulation or any provision of the Act unless it made specific findings of necessity,⁷ required the Commission to review all regulations biennially and repeal any that were "no longer necessary in the public interest as a result of meaningful economic competition,"⁸ and, as we have seen above, opened up the interLATA market to potential new facilities-based entrants -- the RBOCs.

An example of what new facilities-based entry can bring may be found in Connecticut. Last year SNET began competing with the big IXCs. Now, following years of broken promises by big IXCs to flow through access charge reductions, real long distance rates in Connecticut are finally

⁵ Joint Explanatory Statement of the Committee of Conference (1996 Act), p. 1.

⁶ See 47 U.S.C. Section 253.

⁷ See 47 U.S.C. Section 10(a).

⁸ See 47 U.S.C. Section 11.

coming down. As of last summer 25% of Connecticut long distance customers had switched to SNET. As if the erosion of its market share threatened the public interest, AT&T requested reconsideration *on behalf of all "national" LXC's* that would allow them to selectively reduce, through regional promotions lasting longer than 90 days, the price of calls originating in Connecticut and any other states where the incumbent LEC offers competing long distance service -- though not the price of calls originating anywhere else.⁹

AT&T has also complained about price competition in the two corridors where Bell Atlantic and NYNEX are authorized, pursuant to an exception in the MFJ, to offer in-region interstate interLATA service. AT&T said that a waiver allowing it to offer geographically targeted promotions of more than 90 days would serve the public interest because consumers would benefit from lower prices and increased competition.¹⁰ If this is so, then why would RBOC entry not lead to lower prices and increased competition everywhere?

As these examples prove, the best approach to rising long distance prices is for other significant carriers to be allowed to enter AT&T's markets. The RBOCs are the potential entrants the oligopoly fears most -- not because they have any incentive or ability to discriminate, as the oligopoly pretends, but because they have the incentive and ability to bring down prices. Moreover, because of their local brand identities and sales channels, they have a particular incentive and ability to bring competition to the market segment that needs it most: the majority of customers who are not on

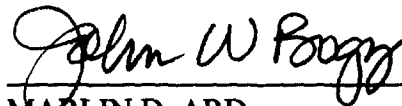
⁹ See AT&T Corp's Petition for Reconsideration, CC Docket No. 96-61, filed September 16, 1996.

¹⁰ *Policy and Rules Concerned the Interstate, Interexchange Marketplace*, CC Docket No. 96-61, Order, DA 97-129 (released January 17, 1997), p. 3.

special pricing plans and whose prices the big IXC's have steadily raised. The Commission should encourage the rapid entry of the RBOCs to AT&T's long distance markets.

Respectfully submitted,

PACIFIC TELESIS GROUP

A handwritten signature in dark ink, appearing to read "John W. Boggy", is written over a horizontal line.

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Its Attorneys

Date: March 3, 1997

CERTIFICATE OF SERVICE

I, Cheryl A. Peters, hereby certify that on this 3rd day of March, 1997 a true and correct copy of the foregoing Reply of Pacific Telesis Group was mailed, first class postage prepaid , to the parties shown below.

Richard H. Rubin
AT&T Corporation
295 North Maple Avenue
Basking Ridge, New Jersey 07920

A handwritten signature in black ink, appearing to read 'Cheryl A. Peters', with a long horizontal flourish extending to the right.

Cheryl A. Peters